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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

16 July 1985

South America: Growing Opposition To The IMF [redacted]

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Summary

Broadbased opposition to IMF-supported adjustment programs is growing thoughout South America. Although we judge that most South American debtors will agree to live with some kind of Fund program over the near term, there is a risk that Brazil, Argentina and Peru would seek out financial alternatives--such as direct negotiation with creditors on a "go it alone" strategy in a worst case scenario. Beyond the immediate threat to debt repayments, a break by several of the region's debtors with the Fund would undermine creditors' willingness to provide continued financial support. [redacted] 25X1

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The Challenges to the IMF

As South America's debtors try to balance economic and political realities, governments are increasing calling into question the utility of rigid, IMF-supported adjustment programs. Based on a review of press and diplomatic reporting anti-IMF sentiment is strongest in the Andean countries. Peruvian President-elect Garcia has publicly indicated he will bypass the Fund and negotiate directly with bankers. Colombian President Betancur refuses to implement an IMF-supported stabilization program for fear of the political consequences. Venezuela's Lusinchi has publicly stated his pride at obtaining a multiyear rescheduling without IMF conditions, thereby preserving Venezuela's "economic sovereignty." Bolivia's President Siles has been adamant in his refusal to undertake a Fund program, although Hugo Banzer, currently the leader in Bolivia's

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This typescript memorandum was prepared for Mr. Ciro De Falco, Director, Developing Nations Finance, Department of the Treasury, by [redacted] Office of African and Latin American Analysis, South America Division. [redacted]

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State Dept. review completed

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presidential election race, indicates he will seek such a program. [redacted] 25X1

Most of South America's other civilian presidents--the final arbiters on debt policy--are generally taking tougher stances toward the IMF in the face of popular demands for economic improvements but are continuing to cooperate with the Fund on implementing stabilization programs: 25X1

- According to the press [redacted] Brazil's Sarney feels increasing ill will toward the IMF, which he describes as "insensitive", but his financial team continues to negotiate for a new agreement.

- Argentina's Alfonsin and Uruguay's Sanguinetti have recently completed successful negotiations with the IMF but pushed hard for and received more realistic targets.

- 25X1 Ecuadorean President Febres Cordero and Chile's Pinochet remain publicly committed to their new IMF agreements. [redacted] 25X1

Despite the willingness of most governments to cooperate, US Embassy reports [redacted] point to continuing difficulty in meeting IMF performance criteria. Looking ahead, the principal challenges to the stabilization programs, in our opinion, will come from an array of domestic interest groups most affected by the adjustment measures and the conflicting demands they make on the governments. Powerful labor unions in Argentina and Uruguay for example are becoming strident in their criticism of IMF recommendations that curb wage increases and raise the cost of living by reducing consumer subsidies. Influential middle-class constituents are questioning the advisability of IMF-recommended adjustments that reduce living standards, slow economic growth, and threaten social stability, according to public opinion polls. In Brazil, for example, over half of those polled considered agreement with the IMF harmful. The increasingly important democratic legislatures will likely become more involved in financial matters; Brazil's Congress has already served notice that it intends to scrutinize any new debt accords. Despite their lack of influence, leftists--including radical factions in Argentina, Brazil, Uruguay and Ecuador--are advocating repudiation of IMF agreements to restore social spending and accelerate growth. Castro, in a strategy which plays to public discontent, is strongly criticizing the social costs imposed by IMF-supported economic stabilization programs. [redacted] 25X1

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In our judgment, government opposition to the IMF in South America primarily reflects growing concern among Latin leaders about the political costs of economic adjustment. These concerns are publicly manifest in statements issued by the Cartagena group since 1984 appealing to the IMF to ease its conditionality requirements to prevent political unrest in the region. Although Latin debtors support easier terms, we have no evidence

[redacted] 25X1

that indicates that South American debtors are formally coordinating their opposition to the IMF. [redacted] 25X1

Although we judge that most of the region's leaders recognize the necessity of stabilization to retain the cooperation of creditors, they also seem willing to take a tougher stand on the politically risky aspects of the IMF's recommendations. Consequently, we believe most of the largest debtors will likely agree to new IMF programs but only after several months of rancorous negotiations aimed at securing more lenient performance targets. For example, while the Brazilian Central Bank and Finance Ministry are negotiating seriously for a revised Fund agreement, [redacted] 25X1 25X1 [redacted] wrangling over the public sector deficit, inflation figures, and elimination of subsidies will impede quick Brazilian agreement on a revised program. [redacted] 25X1

Financial Alternatives and the Consequences

If the Fund proves uncompromising in setting economic targets, we believe there is a moderate chance that some South American debtors will seek to bypass the IMF and negotiate directly with creditors.

- Brazil--which abrogated its 1962 Fund agreement--appears increasingly unwilling to acquiesce to IMF demands for tough austerity. If the Fund insists on measures Brasilia regards as draconian in order to achieve a sharp cut in inflation, we judge Sarney would abrogate relations and probably press foreign bankers for a multiyear debt rescheduling without an IMF program.

- Argentina's self-sufficiency in food and fuel puts it in the strongest position to repudiate its debt. If Buenos Aires's $4.2 billion foreign financial package falls through, it may again consider plans to suspend interest payments in an attempt to gain easier repayment terms. [redacted] 25X1

A chance exists that one or more smaller debtors also may seek to "go it alone." We believe that Peru will probably break relations with the IMF temporarily and try to negotiate concessions directly with bankers, a policy it attempted in 1976. We judge that Garcia's tougher line toward the IMF is partially motivated by the need to gain domestic acquiescence to additional belt-tightening measures. In that case, his tactic could eventually set the stage for a self-imposed stabilization program monitored by the Fund. More worrisome, however, is the prospect that Garcia's anti-IMF stance could cause bankers to cease any new financial support. If such a confrontation develops, we believe Lima will suspend all commercial debt repayments and pursue policies aimed at achieving economic and financial self-sufficiency. [redacted]

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It is not only the debtor-IMF relationship that is in question. In our judgment, commercial bankers may soon be forced to reassess their partnership with the IMF. Should Brazil abrogate its agreement with the Fund, we believe creditors may accede to a multiyear rescheduling but only on the basis of a self-imposed stabilization program. We judge, however, that Brasilia would encounter stiff banker resistance in putting together any future new money facility, thereby remaining vulnerable to continuing funding problems. On the basis of creditor reactions to date, we believe several debtors breaking with Fund programs in quick succession would lead to a near cessation of new credit to the region, which would immediately strain repayment capabilities for many debtors. For the longer run, we believe lending and repayment decisions would be more discretionary, heightening both the potential for confrontation between creditors and debtors and the risk of prolonged payments suspensions.

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